

1 UNITED STATES DISTRICT COURT
 2 FOR THE EASTERN DISTRICT OF VIRGINIA
 3 Alexandria Division

4 PACEM SOLUTIONS INTERNATIONAL, : Civil Case
 5 LLC, : No. 1:23-cv-1702

6 Plaintiff :

7 v. :

8 U.S. SMALL BUSINESS :
 9 ADMINISTRATION, et al., : September 6, 2024
 10 : 10:25 a.m.

11 Defendants :

12 :

13 TRANSCRIPT OF MOTION HEARING
 14 BEFORE THE HONORABLE LEONIE M. BRINKEMA
 15 UNITED STATES DISTRICT JUDGE

16 APPEARANCES:

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COMPUTERIZED TRANSCRIPTION OF STENOGRAPHIC NOTES

1 Right?

2 MR. BAUMHART: That's correct. One-year fully
3 amortizing loan.

4 THE COURT: Right. And as you know from the history of
5 this case, that loan was modified and modified and modified and
6 modified and modified. It was pretty clear from at least the
7 record of the case that the plaintiff was only able to make
8 interest-only payments, never was able to make the final
9 payments of the principal. On I think two of the modified or
10 redone loans, a small portion of principal was paid, but it's
11 pretty clear from the track record that it was never able to pay
12 the full principal.

13 I was surprised, at least with what I could see in the
14 record, that the SBA does not require that it receives notice if
15 the loan for which it entered the guarantee is modified; that it
16 doesn't get notice and an opportunity to voice an objection. Is
17 that really how you-all operate?

18 MR. BAUMHART: Your Honor, I can't speak to exactly the
19 procedure that occurred beforehand. I believe that the SBA
20 receives a minimum notification of continuing payments that are
21 being made on a loan --

22 THE COURT: And to assume, then, that the loan has been
23 extended somehow by the bank?

24 MR. BAUMHART: Yes, Your Honor. Through the 1502
25 reports. And they rely on the lenders to report whether the

1 loan is in regular servicing status or has alternatively moved
2 to liquidation.

3 THE COURT: Now, if a financial institution is not
4 following SBA requirements by making the proper reports or not
5 doing the proper due diligence, frankly, in checking out whether
6 a borrower is qualified to even receive this type of SBA
7 guaranteed loan, does the SBA cut off relationships with the
8 bank? Is that something that happens?

9 MR. BAUMHART: Your Honor, I think the SBA has a range
10 of sanctions, punishments, that kind of thing, that it can dole
11 out. It is possible, I think, that the SBA would no longer have
12 that lender within its portfolio. I don't know the full range
13 of what sanctions they would impose or, you know, what sort of
14 triggering facts --

15 THE COURT: It was interesting, if you look at the
16 communications from the final bank that was handling the note in
17 its final iteration - because it was not the origination bank -
18 how they were sort of saying, well, we wouldn't do it this way.
19 But they had, in fact, been involved in several of the
20 extensions of this agreement.

21 All right. Well, anyway, I was just intrigued by that,
22 because there were certainly major changes made to the original
23 note in terms of the agreement as to how principal-only payments
24 versus the final payment of principal would occur.

25 MR. BAUMHART: That's certainly correct, Your Honor.

1 It went from regular payments of principal to essentially no
2 principal, interest only, and then a balloon payment, if you
3 will, at the end that was also never made.

4 THE COURT: All right.

5 MR. BAUMHART: Thank you.

6 THE COURT: So the issue is whether or not, first of
7 all, the SBA acted in an arbitrary or capricious or illegal
8 manner when it made the decision that it was not going to
9 continue paying. Because what happened, of course, when the
10 CARES Act went into effect, the CARES Act did provide that the
11 SBA would come forward and would cover loans that qualified for
12 such coverage. And the SBA -- one of the things that makes a
13 loan not a qualifying loan is if it's in default.

14 And I don't think there's any way in which the
15 plaintiff can really argue from this record that the loan was
16 not in default. In fact, the fifth version even says that the
17 loan was in default and that the bank was waiving the default.
18 But default is default.

19 And again, I'm curious whether a bank's waiving of the
20 default saves that loan. Because, again, the SBA represents the
21 taxpayers. That's taxpayer money that is being used to
22 guarantee the loan. And the CARES Act, it was quite clear that
23 if the loan was not performing appropriately, that SBA was not
24 required, as I understand it, to make the payments.

25 So the SBA did make two interest payments and then

1 realized that this loan was not a qualifying loan, and you know
2 from the record, the bank returned those two payments to the SBA
3 and then the SBA refused to make the other payments.

4 The other thing that's really strange in this case, and
5 the timing is very unusual, is that after the CARES Act goes
6 into effect, all of a sudden the sixth version of the loan
7 occurs, and for the first time the payments are all principal
8 payments. I mean, it upped the ante so dramatically such that
9 the SBA might be caught in having to pay the whole principal
10 because of that change. That's very problematic. I mean, I saw
11 all sorts of strange things with that.

12 So, Mr. Johns, you'll have to show me where you really
13 think the action of the SBA was in any respect arbitrary,
14 capricious, or illegal, whether it violated the CARES Act, and
15 whether your client -- you know, your client, in terms of due
16 process, he's even here today, or it's even here today. It's
17 getting processed. But your due process argument is, from what
18 I read, primarily defects in certain notifications, which are at
19 best harmless, in my view.

20 But go ahead.

21 MR. JOHNS: Thank you, Your Honor. And I think to
22 respond to Your Honor's questions, the incident that in the
23 complaint PACEM points to is the stoppage in payments of the
24 loan, the subsidy payments for the loan. It was accepted into
25 the program, and it was accepted after the execution of that

1 fifth amendment.

2 And at the time that those payments were stopped in the
3 summer, we don't know exactly -- there was a June 1st payment
4 that covered the April and May payments under the loan --

5 THE COURT: Under the CARES Act.

6 MR. JOHNS: And then there should have -- yes,
7 Your Honor. And so there would have been, under the CARES Act,
8 four more monthly payments.

9 THE COURT: Yeah, but those monthly payments now are
10 principal. You've never had -- in all the iterations of this
11 loan, there has never been a situation where the monthly
12 payments basically became portions of that very significant --
13 it's \$4.6 million. I mean, very significant principal. Almost
14 all of the other iterations, and certainly later iterations,
15 were interest only, which is a huge difference.

16 MR. JOHNS: Well, the issue for APA purposes, and the
17 issue why we're here, Your Honor, is that there's nothing in the
18 administrative record that shows any of that thought process in
19 May of 2020 or the summer of 2020, when those payments were
20 stopped. Everything in the record occurs after that decision.

21 And PACEM -- perhaps the lender would have had an
22 opportunity to explain it if the SBA had followed the proper
23 procedure and given notice before taking the action. And that
24 didn't happen. There's literally nothing in the record that
25 shows any decision-making process at the time that they stopped

1 the payments.

2 And then the record does reflect the odyssey that PACEM
3 enters into to try to find out the reason, to try to find out
4 that rational basis, and all of that comes after the fact. The
5 loan payments have stopped in the summer of 2020. There's
6 nothing in the record that indicates why that happened at the
7 time of that stoppage.

8 And under the APA, under due process, there may have
9 been an opportunity to provide that explanation. There may be a
10 very reasonable basis. The payments actually, for the remaining
11 six months after the -- let me take one step back.

12 The fifth amendment, which was approved, had a balloon
13 payment as of the 15th of June. And so the entire loan was to
14 be paid off in June of 2020 under the fifth amendment of that
15 loan. The sixth amendment of that loan extended the payments
16 until December. So --

17 THE COURT: Excuse me. What was the consideration for
18 the bank in extending that sixth iteration? In many of the
19 other ones there was a requirement that some portion of the
20 principal be paid. One payment was 250,000 and I think another
21 one was 100,000. So there was clear consideration to the bank.
22 There was a benefit to the bank.

23 There was none that I could find for the sixth.

24 MR. JOHNS: Two points, if I may, Your Honor. First of
25 all, the waiver provision has been in that note since the very

1 beginning, that the bank, instead of entering into default, may
2 waive under a number of conditions.

3 The sixth amendment, there's a requirement for payment
4 of the bank's fees, as I'm --

5 THE COURT: Of 2,500 -- yeah, the two \$2,500 payments.
6 That's right. Yeah.

7 MR. JOHNS: Right. So there is this consideration that
8 they had to pay those fees.

9 So I think that the fifth amendment, the
10 fifth amendment loan, was actually worse for the SBA. The
11 sixth amendment, the payments would have stopped in September,
12 but the loan payments continued until December. But the problem
13 is that there was -- under the APA, there's nothing in that
14 record for that decision to stop those payments. And I don't
15 think the agency can get past that.

16 All of the material that Your Honor referred to, and
17 it's in the record, we don't contest what's in -- I mean, the
18 record is the record. But none of that was available to the
19 decisionmakers in the summer of 2020, at the time they stopped
20 those payments. And that was considering that two payments had
21 been made. That was a deprivation of the rights. That was an
22 injury under the APA.

23 And so the issue of whether it's in regular servicing,
24 the CARES Act defines it for this loan that's now been accepted.
25 There's no indication in the record at the time that the

1 payments were stopped that the loan was not in regular servicing
2 in May, June, July of 2020, because the two payments were made.
3 The payment that was missed was because SBA stopped making the
4 payments. And so -- and it had been less than 120 days at that
5 point. Again, under the regulations and the CARES Act, you
6 can't consider a loan that's more than 120 days in arrearage as
7 not in regular servicing.

8 So at best, one payment is late because the SBA didn't
9 make the payment they were supposed to make, and then payments
10 get stopped with no notice, with no decision, and there's
11 nothing in the record.

12 THE COURT: All right. Mr. Baumhart, do you want to
13 respond to that?

14 MR. JOHNS: Thank you, Your Honor.

15 MR. BAUMHART: Just briefly, Your Honor. It's simply
16 not true that there's nothing in the record reflecting that
17 there was an issue in actually April of 2020. The May 2020
18 1502 report, which, again, is submitted by the lender, indicated
19 there was a missed payment in April. I know the plaintiff has
20 raised an issue about, well, that version of the spreadsheet
21 wasn't available in 2020 because it has subsequent information
22 in it.

23 That's not how the compilation of the administrative
24 record works. It's -- as long -- it accurately reflects, and I
25 don't think there's been any dispute that the compilation

1 accurately reflects, the information that the SBA received,
2 again, from the lender, that indicated that there was a
3 delinquency and that was why the payments were stopped.

4 And then, when the lender reached out in August to say,
5 Why aren't we getting paid? The SBA said, We see this
6 delinquency; have you tried contacting the fiscal transfer
7 agent?

8 That is also, by the way, what sort of keyed the SBA
9 into this particular loan and said, well, now we have this
10 discrepancy, let's take a look sort of behind the curtain. And
11 that's when the whole history of the loan became clear, and just
12 a year and a half of non-payment of principal that the SBA
13 ultimately relied on in its final decision that is reflected in
14 the letter that the SBA sent to the lender, and also is alluded
15 to in the email that the SBA sent to the plaintiff.

16 THE COURT: I am satisfied in this case that the SBA
17 had a sufficient record before it at the time it made its
18 decision to stop the payments, and then certainly fully
19 evaluated and developed and explained over the course of the
20 almost two years, I guess, that this thing was being discussed
21 administratively, that it acted in -- it did not act in an
22 arbitrary, capricious, or illegal manner.

23 I think it did not violate the CARES Act, and the
24 plaintiff has gotten adequate due process.

25 So I'm going to deny the motion for summary judgment

1 that the plaintiff has filed and grant the defendant's motion
2 for summary judgment. Thank you.

3 MR. JOHNS: Thank you, Your Honor.

4 MR. BAUMHART: Thank you, Your Honor.

5 (Off the record at 10:42 a.m.)

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16

17 I, Rebecca Stonestreet, certify that the foregoing is a
18 correct transcript from the record of proceedings in the
19 above-entitled matter.

20

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22 _____/Rebecca Stonestreet_____

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DATE

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